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IN THE

Supreme Court of the United States

DURA PHARMACEUTICALS, INC.; CAM L. GARNER; JAMES W. NEWMAN; CHARLES W. PRETTYMAN; WALTER F. SPATH; JULIA R. BROWN; JOSEPH C. COOK, JR.; and MITCHELL R. WOODBURY,

Petitioners,

v.

MICHAEL BROUDO; BALDEV S. GILL; LARRY MORGAN IRA; LEONID SHVARTSMAN, (for G&S partnership); NEIL SISKIND; ROBERTA SPECK; BRENT VOGT, on behalf of themselves and all others similarly situated,

Respondents.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF

WILLIAM F. SULLIVAN
Counsel of Record
CHRISTOPHER H. MCGRATH
TRACEY L. DELANGE
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

Attorneys for Petitioners

191681

COUNSEL PRESS
(800) 274-[illegible]1 • (800) 359-6859

STATEMENT PURSUANT TO RULE 29.6

Petitioner's Rule 29.6 Statement was set forth at page *ii* of Petitioner's Opening Brief, and there are no amendments to that Statement.

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INTRODUCTION

The price inflation theory urged by respondents and adopted by the Ninth Circuit has been aptly summarized by petitioners and the Securities and Exchange Commission ("SEC") as one which improperly removes the fundamental "loss" component from "loss causation" – one of the elements necessary to successfully plead and prove a securities fraud claim under Section 10(b). Respondents argue that all they need allege is that a security was inflated when it was purchased, whether or not the alleged "loss" was ever realized. This result would negate entirely the necessity of pleading the loss causation element at all.

Respondents' price inflation theory cannot be reconciled with the loss causation provisions of the Reform Act, which specifically require that a plaintiff plead and prove "that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." 15 U.S.C. § 78u-4(b)(4). Nor is it consistent with (1) the overall statutory scheme of the Reform Act, which contains a limitation of damages provision that defines a plaintiff's damages in terms of a post-transaction decline in value following a corrective disclosure, (2) the loss causation provision of Section 105 of the Reform Act, which expressly defines loss causation in terms of a direct link between a defendant's misconduct and a "depreciation" in the value of stock or (3) Section 28 of the Securities Exchange Act of 1934, which provides that a plaintiff may not recover an "amount in excess of his actual damages on account of" a violation of the securities laws. 15 U.S.C. § 78bb(a). Moreover, respondents have never addressed the fundamental inconsistency between their price inflation theory and the failure of an efficient market to record a decline when a correction is made.

Respondents' suggestion that the majority rule sought by petitioners would be disastrous for investors and the integrity of our securities markets is best measured against the position in this case of the principal Government agency charged with

securities law enforcement, the SEC. The SEC's view is that respondents' price inflation theory is wrong, contrary to the Reform Act, and one which would lead to improper windfalls for plaintiffs while deterring beneficial securities activities.

I. THE REFORM ACT CLEARLY REQUIRES THAT PLAINTIFFS PLEAD AND PROVE LOSS CAUSATION

In passing the Reform Act, Congress sought to establish uniform and stringent requirements for putative securities fraud actions arising under Section 10(b). Pet. Br. at 14-15. To that end, Congress codified a plaintiff's burden of pleading and proving "loss causation" in Section 21D(b)(4) of the Reform Act. 15 U.S.C. § 78u-4(b)(4).

A. Respondents' Price Inflation Theory Is Not Consistent With The Reform Act's "Look Back" Provision

Respondents acknowledge that at the same time Congress codified loss causation in the Reform Act, it also implemented an upward damages limitation in Section 21D(e)(1), which provides that:

> in any private action arising under this chapter in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which *the information correcting the misstatement or omission that is the basis for the action is disseminated to the market*.

15 U.S.C. § 78u-4(e)(1) (emphasis added). Petitioners have previously detailed how respondents' price inflation theory, which requires no stock price decline, is fundamentally inconsistent with a "look back" provision designed to limit

plaintiffs' potentially available damages where a stock does not decline, or declines but then recovers. Pet. Br. at 15-17.

Remarkably, respondents argue (at 38) that, rather than negating their theory, the "look back" provision evidences Congress' intent to "fix loss" at the time the security is purchased at an inflated price. On the contrary, the "look back" provision makes clear that the loss is analyzed in terms of "the difference between" the inflated purchase price and "the trading price" *after* the misrepresentation is corrected. This damages provision thus comports precisely with the majority rule, not respondents' theory. *See Reno v. Koray*, 515 U.S. 50, 56 (1995) (a court must interpret a statute as a coherent harmonious whole).

Respondents also mistakenly assert (at 38-41) that the "look back" provision will prevent the inevitable windfalls to plaintiffs under their price inflation theory. In doing so, respondents evidence a fundamental confusion between liability and damages. (Amicus Regents of the University of California (at 9) actually calls it "immaterial" whether investment loss is considered an element of liability or of damages.) Leaving the determination of whether a plaintiff suffered a loss to the damages stage gets things backwards. Congress determined that a defendant cannot be liable for securities fraud unless it caused the plaintiff to incur a loss. 15 U.S.C. §§ 78u-4(b)(4), 78bb(a). Thus, an investment loss caused by the alleged fraud is an element of liability, not merely an issue to be determined when calculating the amount of damages. Respondents and their amici seek to leap over their burden to plead and prove the proper causal nexus as part of their liability case and suspend it until the damages computation stage. There is no basis, however, for a damages proceeding where the defendant did not cause the plaintiff any loss. *See Simon v. First Interstate*, 516 F.2d 303, 306 (2d Cir. 1975) (the "rule that uncertainty as to the amount of damages is to be cast on the wrongdoer does not extend to uncertainty as to the fact of damages"). Moreover, postponing the necessary inquiry until the final stage of litigation would

open the door to coercive class action settlements in the vast majority of cases that do not proceed to trial.

B. Respondents' Price Inflation Theory Is Not Consistent With Section 105 Of The Reform Act

At the same time it codified the required element of loss causation for securities fraud actions under the Exchange Act, in Section 105 of the Reform Act, Congress also codified the element of loss causation as applied to private actions brought under Section 12 of the Securities Act of 1933. PL 104-67 § 105; 15 U.S.C. § 77l(b). Section 105 clearly defines "loss causation" in terms of the direct link between defendants' false statements and the "depreciation in value of the subject security. . . ." Pet. Br. at 18-21. Consequently, Congress intended that price inflation without a decline would not be a "loss" for purposes of loss causation.

Respondents do not and cannot dispute that Section 105 defines loss causation in this fashion. Respondents instead discourse upon the differences between Section 12 and Section 10(b). Resp. Br. at 35-38.[1] Although Respondents spend a great deal of time distinguishing between "out of pocket" damage measures frequently associated with Section 10(b) and rescissory-based damages under the 1933 Act, respondents concede (at 36-37) that Section 10(b) claims may also be subject to rescissory measures, thus obviating the ostensible point of their distinction. *See also Randall v. Loftsgaarden*, 478 U.S. 647, 661-62 (1986). The significance of the *definition* of loss causation in Section 105 to mean "depreciation" is in any event not affected by what measure of damages is employed, and whether they are "out of pocket" or "rescissory." Rather, Section 105 defines the nature of "loss" itself and instructs how that loss must be manifested and caused.

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1. In prior interpretations of the federal securities laws, this Court has comprehensively analyzed the broad statutory scheme. *See, e.g., Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 174-80 (1994); *Chiarella v. United States*, 445 U.S. 222, 234 (1988).

No aspect of respondents' argument can overcome the fact that Congress in the Reform Act stated that loss causation requires a "depreciation in value of the subject security resulting from" the alleged violation. If Congress intended loss causation to have a vastly different meaning elsewhere in the same Reform Act, it would have said so. *See Colautti v. Franklin*, 439 U.S. 379, 392 (1979) (Congress "presumably" intended statutory definition "to be the exclusive definition ... throughout the Act"); *Meese v. Keene*, 481 U.S. 465, 484 (1987). Were respondents' price inflation rule to be adopted, it would result in two different definitions of loss causation within the Reform Act, thereby violating fundamental principles of statutory construction. *Id.*; *see also Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 860 (1986) ("identical words used in different parts of the same act are intended to have the same meaning").

C. Respondents' Price Inflation Theory Is Not Consistent With Pre-Reform Act Provisions Of The Federal Securities Laws

Respondents incorrectly argue that the Exchange Act codified their price inflation rule. Resp. Br. at 16-17. On the contrary, the measure of damages in claims under Section 10(b) is governed by Section 28(a) of the Exchange Act, which provides that an investor may not recover an "amount in excess of his *actual damages on account of*" a violation of the securities laws, meaning the investor's actual monetary loss. 15 U.S.C. § 78bb(a) (emphasis added); *see Randall*, 478 U.S. at 662-63; *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 154-55 (1972). Respondents' price inflation rule is inconsistent with "actual damages on account of" or attributable to specific misrepresentations or omissions which can be linked to the alleged loss. Respondents' theory could make defendants potentially liable not only to those investors who can prove a price decline caused by the defendants' conduct, but also to investors who did not lose money as a result of the defendants' conduct, because they sold before the conduct was exposed and the price dropped or because the price dropped for other reasons.

It would also allow recovery by plaintiffs who proffer only speculative theories of loss causation and whose losses are attributable to extraneous market flucuations. *See* S. Rep. No. 104-98 at 7 (1995), *reprinted in* 1995 U.S.C.C. A.14, 679, 686. The majority loss causation rule, by contrast, is fully consistent with the statute's "actual damages on account of" requirement. This rule makes damages available only to investors who can show that the losses they suffered were "on account of" specific misrepresentations or omissions made by the defendant, as demonstrated by a distinct market price adjustment upon disclosure of the specific, correct information. When price declines have other causes, such as publicly available information about other, nonfraudulent facts about the company, the industry, or the general market, such declines are not "actual damages" caused by the defendant.[2]

Not surprisingly, respondents' argument ignores Section 28(a) entirely and instead relies exclusively on an analogy to Section 9(e) of the Exchange Act, which governs market manipulation activities, including transactions by issuers in their own securities. 15 U.S.C. § 78i. Respondents selectively cite dicta from *Piper v. Chris-Craft Indus.*, 430 U.S. 1, 46 (1977), for the proposition that Section 9(e) speaks in terms of the recovery of an "improper premium" over the price the security would have traded at absent the manipulation. *Piper* actually involved standing to sue under Rule 10b-6, and the Court expressly stated that Section 9(e) is *"[u]nlike § 10(b)"* by providing for an express cause of action "in favor of 'any person who shall purchase or sell any security at a price which was affected by such act or transaction.'" 430 U.S. at 46 (emphasis added).[3] When Congress amended Section 10(b) in the Reform

2. For additional discussion of Section 28(a) and related damage limitations under the securities laws, *see* the Amicus Briefs of the SIA at 14-17 and Merrill Lynch at 7-11.

3. This Court's reference to Section 9 in *Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 476 (1977), was solely for the purpose of identifying manipulative practices in the securities markets, and the Court declined to apply it to the plaintiffs' Section 10(b) claims.

Act, it did not reproduce the Section 9(e) language, instead requiring plaintiffs to plead and prove that the defendant's act or omission "caused the loss for which the plaintiff seeks to recover damages", a requirement which as a consequence of the Reform Act is now equally applicable to Section 9(e).[4]

In any event, a market manipulation case is fundamentally different from a fraud on the market case. In a manipulation case, if there was harm, the stock declines when the manipulation ceases, even if both the manipulation and its cessation remain unknown. There is no open market reaction to a public event to show if there was harm and how much. In a fraud on the market case, if there was fraud, the stock price declines only when the market learns of corrective information. The market's reaction shows both if there was harm and is indicative of how much.

D. The Legislative History Does Not Evidence That Price Inflation Alone Is Sufficient To Plead And Prove Loss

Legislative history is resorted to only when necessary to interpret ambiguous statutory text. *See, e.g., Bedroc Limited, LLC v. United States*, 541 U.S. 176, 124 S. Ct. 1587, 1593

4. The loss causation requirement applies to "any private action arising under" Title I of the Exchange Act. 15 U.S.C. § 78u-4(b)(4). Respondents' reliance upon Section 9(e) is ironic given that plaintiffs routinely avoid using that provision because of its difficult proof requirements. *See* IX Loss & Seligman, SECURITIES REGULATION 4280 (3d ed. 2004) (Section 9(e) "has been virtually a dead letter so far as producing recoveries is concerned"). Loss & Seligman also refer to uncertainty whether Section 9(e) requires apportionment of market losses between recoverable losses caused by manipulation and non-recoverable ones attributable to other causes, noting that the "apportionment concept may be inherent in the phrase, 'sustained as a result,' in § 9(e)" or in "the phrase, 'at a price which was affected by.'" *Id.* at 4281 n.200. If Section 9(e) was more than a "dead letter," no doubt courts would have had to consider loss causation standards to be derived from the "affected by" and "sustained as a result" phrases closely, which this Court had no need to do in its dicta in *Piper*. In short, a little-used provision that was not Congress' focus in the Reform Act is not informative of loss causation under Section 10(b).

(2004). The Reform Act's loss causation requirements, including the definition of Section 105 requiring "depreciation," are not ambiguous and no such reference is necessary. In any event, legislative history plainly supports petitioners' interpretation. Pet. Br. at 22-26.

Respondents point to references in the legislative history to "artificial inflation." Resp. Br. at 25-30. That there are such references is hardly surprising because if there was no inflation, corrective information will not cause depreciation.[5] In order to conclude from those references, however, that artificial inflation is all that need be demonstrated to establish loss, respondents depend upon an inappropriately selective treatment of the legislative history.

For example, respondents (at 28) rely upon a May 11, 1995 letter from SEC Chairman Arthur Levitt to Senator Richard Bryan describing S. 240 as making it clear that "plaintiff is required to prove that the misstatement or omission caused his loss; i.e., that the price at which the plaintiff purchased his shares was artificially inflated as a result of the misstatement or omission." But Chairman Levitt went on to make clear his understanding that liability under Section 10(b) depends on there being:

> no other factors, unrelated to the fraud, *that contributed*

5. Consequently, it is hardly informative that analyses of early House and Senate bills suggested "plaintiff has the burden of showing that the misstatement or omission caused the loss" (141 Cong. Rec. S1086-87 (Jan. 18, 1995) or that plaintiffs would have to establish that defendant's misstatement or omission "established the market price at which the plaintiff purchased or sold the securities in question." *Id.* None of these propositions suggest that plaintiffs need not demonstrate actual loss. Further, it is puzzling that respondents make reference to the Banking Committee's deleted amendment to the Senate bill regarding defendants' ability to mitigate damages alleged by plaintiff by showing that other factors contributed to the loss. Resp. Br. at 28. The deletion of the sentence in Conference demonstrates either an intent by Congress not to adopt respondents' position or Congress' understanding that loss causation made such a mitigation defense redundant. *Id.*

> *to a decline in share price following the disclosure of corrective information.*[6]

It is in this context – clearly presupposing a decline in share price following a corrective disclosure– that the House Conference Report confirmed that plaintiffs were required to plead and prove "that the misstatement or omission alleged in the complaint actually caused the loss incurred by the plaintiff" (H.R. Conf. Rep. 104-369 at 41 (1995), reprinted in 1995 U.S.C.C.A.N. 730, 740),[7] and that the Senate Report stated that the loss causation requirement was "codifying the requirement under current law that plaintiff prove that the *loss in the value of their stock* was caused by the Section 10(b) violation and not by other factors." S. Rep. No. 104-98 at 7 (1995), *reprinted in*

6. Letter from Arthur Levitt to Senator Richard Bryan, at 8 (May 11, 1995) (described in respondents' November 17 letter) (emphasis added).

7. Predictably, respondents emphasize the example cited in the Conference Report that plaintiff would have to prove that the price at which the plaintiff bought the stock was artificially inflated as a result of the misstatement or omission." Resp. Br. at 29-30 (citing S. Rep. No. 104-98, at 7, 15). Again, as the SEC observed "it is not likely that this lone sentence . . . reflects a considered congressional judgment as to the standard for establishing loss causation in a Rule 10b-5 case." U.S. Br. at 27. The SEC explains:

> A contrary conclusion would be particularly unwarranted in light of the statement in a different portion of the same Senate Report that the loss-causation provision of the 1934 Act "codif[ies] the requirement under current law that plaintiffs prove that the loss in the value of their stock was caused by the Section 10(b) violation and not by other factors."

Id.; *see also Timbers*, 484 U.S. at 380 (generalizations contained in legislative history are inadequate to overcome the plain textual meaning contained elsewhere in the statute). Respondents' cite to *Basic* in support of their rule again confuses the transaction causation addressed in *Basic* with loss causation. Resp. Br. at 30 (citing 485 U.S. at 243-45).

1995 U.S.C.C.A.N. 679, 686 (emphasis added). "[L]oss in the value their stock" must mean depreciation.[8]

E. Respondents' Attempts To Distinguish The Burdens Of "Pleading" And "Proof" Under The Reform Act Are Disingenuous

In order to evade application of the loss causation standard, respondents now assert the counterintuitive premise that the Reform Act requires only that they prove loss causation, but not that they satisfactorily plead loss causation in their complaint. Resp. Br. at 30-34. Respondents posit this result because Section 21D(b)(4) speaks in terms of "proof" and does not expressly state "pleading." This is a false distinction.

First, loss causation has been recognized as a required element of a securities fraud claim under Section 10(b) for at least thirty years. *See Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974). To suggest that an element of a securities fraud claim need not be pleaded is a non-starter.[9] Second, as the SEC explains, loss causation as an element of a fraud cause of action, must be stated with particularity under

8. In light of the clear statutory scheme discussed, *supra*, at 2-5, any ambiguity respondents suggest with respect to selected portions of the Reform Act's legislative history merely means that such history is not a useful tool for statutory interpretation in this case. *See Citizens to Preserve Overton Park, Inc. v. Volpe*, 401 U.S. 402, 413 n.29 (1971) (where the legislative history is ambiguous, the Court must look to the statutes themselves to find the legislative intent).

9. *See Santa Fe Industries., Inc. v. Green*, 430 U.S. 462, 469 (1977) (reversing Second Circuit's pleading determination that plaintiffs stated a claim under Section 10(b) and Rule 10b-5 holding that mere corporate mismanagement was not within the statute or rule); *see also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 727 (1975) (reversing Ninth Circuit's determination of standing at the motion to dismiss stage, holding that private actions under Rule 10b-5 were limited to actual purchasers or sellers of securities); *cf. Valley Forge Christian College v. Americans United For Separation Of Church And State, Inc.*, 454 U.S. 464, 486-87 (1982) (reversing Court of Appeals decision reversing district court's dismissal of action, holding that plaintiff failed to identify any personal injury suffered by it as consequence of the alleged wrong).

Fed. Rule Civ. Proc. 9(b). U.S. Br. at 15. In addition, it is hornbook law that a complaint must contain either direct allegations on every material point necessary to sustain a recovery or allegations from which an inference fairly may be drawn that evidence on these materials points will be available and introduced at trial. 5 C. Wright & A. Miller, FEDERAL PRACTICE & PROCEDURE § 1216 (3d ed. 2004).[10]

Third, even if there were any ambiguity about the requirement, the Conference Committee report clearly states with respect to "Loss Causation":

> The Conference Committee also requires the plaintiff to *plead and then* to prove that the misstatement or omission alleged in the complaint actually caused the loss incurred by the plaintiff in new Section 21D(b)(4) of the 1934 Act.

H.R. Conf. Rep. No. 104-369, at 41 (emphasis added); *see* S. Rep. No. 104-98, at 15 (addressing loss causation under heading "A strong pleading requirement"); *see also D.E. & J Ltd. Partnership*, 284 F. Supp. 2d at 746-47 ("The legislative history of the [Reform Act] makes it clear that this is a pleading requirement"). Moreover, it is indisputable that the Reform Act was expressly designed to impose higher pleading standards in order to weed out abusive and frivolous securities lawsuits. *See United Savings Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 371 (1988) (provisions that may seem ambiguous in isolation are often clarified by the remainder of the statutory scheme).[11]

10. *Swierkiewicz v. Sorema, N.A.*, 534 U.S. 506 (2002) (Resp. Br. at 30 n.29) is not to the contrary. It applied Rule 8(a)'s simplified pleading standards to an employment discrimination claim and expressly distinguished its holding from fraud cases governed by Rule 9(b); *see also Bass v. E.I. DuPont de Nemours & Co.*, 324 F.3d 761, 764-66 (4th Cir. 2003) (*Swierkiewicz* did not remove plaintiff's burden to allege facts sufficient to state all elements of a claim). *Id.* at 512-13.

11. That other provisions expressly impose heightened pleading requirements with respect to the specific fraudulent statements and

(Cont'd)

As previously outlined by petitioners (at 4-11; *see also* U.S. Br. at 28-29), respondents' complaint contains no direct allegations that the alleged fraud concerning Albuterol Spiros caused them to incur an investment loss nor allegations raising an inference that respondents could prove such loss causation at trial. Indeed, the complaint references only one price decline, and it occurred *before* disclosure of any corrective information about Albuterol Spiros. Just as a court may not assume that a plaintiff "can prove facts that it has not alleged" (*Associated Gen. Contractors*, 459 U.S. at 526), a court may not assume that a plaintiff can prove an essential element of a claim for which it alleges no factual or legal basis.

Respondents further argue (at 33) that "leaving loss causation for proof at trial makes sense." But that is not a legitimate basis for relieving plaintiffs of the obligation to plead loss causation. If the plaintiff must prove that a defendant's act or omission "caused the loss for which the plaintiff seeks to recover damages," as the Reform Act mandates, it makes no sense to wait until trial – after the expenditure of vast court and party resources – to learn that the plaintiff has no good-faith basis for asserting the necessary causal element of their claim. As respondents concede in even advancing this argument, the very problem targeted by Congress in the Reform Act is that, because of the immense pressure to settle, few securities fraud class actions ever get to trial. Once a securities fraud class action

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scienter does not show, as respondents assert (at 31-34), that the loss causation provision does not relate to pleading. Numerous courts have not hesitated to impose it as a pleading requirement. *See, e.g., In re Atlas Air Worldwide Holdings, Inc., Sec. Litig.*, 324 F. Supp. 2d 474, 497 (S.D.N.Y. 2004) (15 U.S.C. § 78u-4(b)(4) requires that plaintiffs "adequately allege a causal connection between the misleading statements or omissions and the decline in value of the securities at issue."); *In re QLT Inc. Sec. Litig.*, 312 F. Supp. 2d 526, 536 (S.D.N.Y. 2004); *D.E. & J Ltd. Partnership v. Conaway*, 284 F. Supp. 2d 719, 746-47 (E.D. Mich. 2003); *Lillard v. Stockton*, 267 F. Supp. 2d 1081, 1109 (N.D. Okla. 2003); *In re Livent, Inc. Sec. Litig.*, 148 F. Supp. 2d 331, 365 (S.D.N.Y. 2001).

survives a dispositive motion, it has a "settlement value to the plaintiff out of any proportion to its prospect of success." *Blue Chip Stamps*, 421 U.S. at 740. That *in terrorem* effect would be heightened if putative class representatives could delay the loss causation inquiry until trial and thereby avoid their burden to show that they can prove investment losses on a class-wide basis. The result would be "extortionate settlements" from which "[i]nvestors always are the ultimate losers." H.R. Conf. Rep. No. 104-369, at 32 (1995).

F. Respondents' Argument That Pre-Reform Act Section 10(b) Precedents Applied Their Price Inflation Theory Is Wrong

Respondents rely upon this Court's references to causation in *Affiliated Ute* and *Basic*, in order to suggest that their theory of loss causation has been embraced previously by this Court and other courts and was the "current law" codified by the Reform Act. Resp. Br. at 13, 25. These precedents, however, do not address loss causation at all.

For example, *Affiliated Ute* involved a direct action by *sellers*, not purchasers, against market makers who purchased stock when they knew and had a duty to disclose that higher prices were available. 406 U.S. at 153. *Affiliated Ute* did not involve, as this case does, an efficient market and the fraud on the market theory; moreover, unlike purchasers, sellers are not affected by post-transaction changes in price. Any seller's loss is fixed and final at the time of the sale. The Court did not discuss loss causation, but rather what would lead a "reasonable investor" in "the making of [its] decision" to invest in a security (406 U.S. at 154) *i.e.*, transaction causation — not loss causation.[12]

12. Respondents' repeated reliance upon the reference to the "causational chain" in *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975) is similarly misplaced, as it primarily addressed transaction causation in a class certification context and whether an investor need demonstrate individual reliance upon a misrepresentation in an efficient market. To the extent it did otherwise, a collapse of loss causation into

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Like *Affiliated Ute*, the plaintiffs in *Basic* were sellers, not purchasers, who sold in advance of an undisclosed merger, and consequently, the case did not involve consideration of a post-transaction decline in price. More importantly, in *Basic* this Court was not addressing loss causation at all, but the rebuttable presumption of reliance – or transaction causation in an efficient market. 485 U.S. at 246-47 (investor's reliance on any public material misrepresentations may be presumed for purposes of a Rule 10b-5 action); *see Robbins v. Koger Properties, Inc.*, 116 F.3d 1441 (11th Cir. 1997) (fraud on the market theory articulated in *Basic* is not presumption of loss causation). Thus, neither *Affiliated Ute* nor *Basic* demonstrate any application of respondents' price inflation theory at all prior to the Reform Act nor do they offer any other support to respondents.[13]

(Cont'd)

transaction causation was the type of outcome members of Congress were attempting to thwart with the Reform Act. Pet. Br. at 29 n.9. Moreover, contrary to respondents' suggestion, statements in *Blackie* about how loss might be determined were entirely dicta, 524 F.2d at 909 n.25, as is the concurrence of Judge Sneed *in Green v. Occidental Petroleum Corp.*, 541 F. 2d 1335, 1344 (9th Cir. 1976) (also reviewing class certification).

13. Respondents' citation (at 21) to Judge Posner's opinion in *Isquith v. Caremark Int'l, Inc.*, 136 F.3d 531 (7th Cir. 1998), for this same proposition is highly misleading. Judge Posner does not define loss causation as the "discrepancy between actual market value" and what the value would have been absent the fraud, but as the "loss produced by" the discrepancy. As he makes clear immediately after the quote respondents rely upon, loss causation would be a "resulting drop in the value of [securities] when the truth emerged." 136 F.3d at 535. The opinion authored by Judge Easterbrook in *Pommer v. Medtest Corp.*, 961 F.2d 620, 628 (7th Cir. 1992) is also of no assistance to respondents as it involved neither an efficient market nor even publicly traded securities. Finally, *Scattergood v. Perelman*, 945 F.2d 618 (3d Cir. 1990) has been interpreted by *Semerenko v. Cendant Corp.*, 223 F.3d 165 (3d Cir. 2000), to be consistent with the proposition that "where the value of the security does not actually decline as a result of an alleged misrepresentation, it cannot be said that there is in fact an economic loss attributable to that misrepresentation." 223 F.3d at 184-85.

Resp. Br. at 25. Respondents' suggestion that their price inflation theory constituted the "current law" codified by the Reform Act is bereft of any support.[14]

G. Respondents' Common Law Tort Precedents Do Not Govern Implied Rights Of Action Under Section 10(b)

Respondents devote considerable attention to common law fraud and deceit precedent from the turn of the century, for the proposition that their statements about the measure of damages arising under tort law comport with their price inflation theory. Resp. Br. at 13-15. Nineteenth century tort law, however, is not relevant here.[15] As this Court stated in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), "the typical fact situation in which the classic tort of misrepresentation and deceit evolved was light years away from the world of commercial transactions to which Rule 10b-5 is applicable" because it involved face to face dealings and not impersonal transactions potentially involving "tens of millions of investors." 421 U.S. at 744-45.

To rely upon these common law cases to supply the loss causation rule under the Reform Act is to ignore the teachings

14. Respondents' related assertion (at 41) that only post-Reform Act cases have held that loss causation requires more than proof of an inflated purchase price is clearly wrong. *See, e.g., Huddleston v. Herman & MacLean*, 640 F.2d 534, 549 (5th Cir. 1981), *aff'd in part and rev'd in part on other grounds*, 450 U.S. 375 (1983); *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990); *see also* Pet. Br. at 23-26. Clearly, these decisions constituted the relevant "current law" on loss causation when the Reform Act was enacted.

15. Moreover, the very precedents cited by respondents (at 14-15) undermine their price inflation theory. *See, e.g., Smith v. Bolles*, 132 U.S. 125, 130 (1889) ("The damage to be recovered must always be the natural and proximate consequence of the act complained of" and "must have been contemplated as the probable consequence of his fraud"); *Sigafus v. Porter*, 179 U.S. 116, 125 (1900) (damages include amounts "legitimately attributable to the defendant's conduct, but not damages covering the expected fruits of unrealized speculation").

of cases from *Blue Chip Stamps* to the Reform Act itself[16] that constraints upon Section 10(b) claims, including those that make it easier "to dispose of [meritless cases] before trial" (*Basic*, 423 U.S. at 742-43), are essential to curb abusive suits and that common law analogues cannot just be superimposed on Section 10(b). It would also ignore the principles underlying this Court's consistent refusal to allow damages actions to proceed on the basis of speculative and indeterminate damage theories.[17] The Reform Act's purpose of ensuring that "plaintiffs prove the loss in the value of their stock was caused by the Section 10(b) violation and not by other factors" is inconsistent with borrowing weak common law conceptions of loss causation. S. Rep. No. 104-98 at 7 (1995), *reprinted in* 1995 U.S.C.C.A.N. 679, 686.

Finally, the common law at the time of the 1995 Reform Act was, from respondents' viewpoint, at best equivocal. As previously shown (Pet. Br. at 31-33) both Prosser & Keeton and the Restatement (2d) of Torts contain examples where there

16. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) (declining to extend Section 10(b) actions to negligent conduct); *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (limiting claims under Section 10(b) and 14(a) to materially misleading omissions); *Santa Fe*, 430 U.S. 462 (1977) (Rule 10b-5 does not extend to mere instances of corporate mismanagement); *Schreiber v. Burlington Northern, Inc.*, 472 U.S. 1, 5-8 (1985) (limiting claims under § 14(e) to manipulative acts involving misrepresentations or nondisclosure); *Central Bank of Denver*, 511 U.S. 164 (1994) (private plaintiff may not maintain aiding and abetting suit under Section 10(b)).

17. *See Blue Chip Stamps*, 421 U.S. at 734-35 (limiting Section 10(b) action to purchasers and sellers of securities because causation of injury to others would be "conjectural and speculative"); *Virginia Bankshares v. Sandberg*, 501 U.S. 1083, 1105-1106 (1991) (refusing to extend Section 14(a) private action to shareholders whose proxy was unnecessary to approval of a transaction to avoid "speculative claims" in which "[c]ausation would turn on inferences" that would be "hazy" and "unreliable"); *Dirks v. SEC*, 463 U.S. 646, 667 n.27 (1983) (declining to give weight to claims of shareholder losses where there was "no clear causal connection between inside trading and outsiders' losses"); *Holmes v. SIPC*, 503 U.S. 258, 268-69 (1992) (precluding recovery of losses that are too indirect, remote or speculative).

is no causation even though there was unquestionably price inflation.

II. RESPONDENTS' PRICE INFLATION THEORY DOES NOT FURTHER THE PURPOSES OF THE SECURITIES LAWS

Respondents suggest (at 9) that the rule urged by petitioners would be "disastrous both for investors and the integrity of our securities markets." Significantly, the SEC, the agency charged with administering and enforcing the securities laws and which has "a strong interest in seeing that the principles applied such actions promote the purposes of the securities laws," holds the opposite view. According to the United States, the Ninth Circuit loss-causation standard is incorrect, and "loss" means a decline in value of the security, and in a fraud-in-the-market case, that necessarily occurs at some point after the security has been purchased. U.S. Br. at 21-22. As the Government observes, respondents' theory renders loss causation effectively indistinguishable from transaction causation, and is inconsistent with the "very idea" of loss causation, that a "plaintiff has no right to recover merely because he purchased a security on false pretenses." *Id.* at 22-23; *see* Conference Report at 31 (Congress sought to prevent "routine filing of lawsuits against issuers ... whenever there is a significant change in an issuer's stock price").

Both petitioners and the United States have warned of the impermissible windfalls that will result if loss is determined at the time of purchase without regard to actual injury, and that such an interpretation puts "issuers in the position of insuring shareholders and purchasers against normal market risk." U.S. Br. at 22, 25; Pet. Br. at 34; *see also* Amicus Brief of SIA at 18-23 (detailing damaging effects of respondents' price inflation theory on the national securities markets).[18] Given that

18. *See also In re Cendant Corp. Litig.*, 264 F.3d 201, 228 n.8 (3d Cir. 2001) (rejecting windfalls associated with such an approach); *Piazza v. Ebsco Industries, Inc.*, 273 F.3d 1341, 1353-54 (11th Cir. 2001) (accord).

federal and state officials and self-regulating organizations have broad criminal and administrative powers to detect and punish fraud, there is no reason to think securities fraud would go unaddressed if the Court adopts the SEC's and petitioners' position. *See* Amicus Br. of Merrill Lynch at 24-30.[19]

Respondents and their amici pretend that a failure to adopt a lax loss causation standard will leave investors without a remedy when a stock declines or completely crashes. Section 10(b), however, does not provide a remedy for every stock price decline. The requirement that plaintiffs plead a price decline attributable to the disclosure of the fraud serves the critical statutory purpose of limiting Rule 10b-5 liability to losses a plaintiff suffers as a direct result of the misrepresentations. In the absence of this requirement, Section 10(b) would become "'a scheme of investors' insurance.'" *Basic*, 485 U.S. at 252 (White, J., concurring in part).

Assertions that culpable defendants will be dismissed if respondents' view of loss causation is not adopted are baseless. Respondents and their amici argue that if a rule were adopted that precluded recovery under Section 10(b) where the value of a stock goes to zero before a fraud is revealed and a corrective disclosure occurs, this result would somehow contravene the purposes of the securities laws. On the contrary, in such a case the cause of the stock's decline, and plaintiff's loss, was something other than the fraud and there should be no viable claim for securities fraud in that context. For example, if a buggy whip company had made misrepresentations that its buggy whips

19. Respondents also argue (at 47) that they should be relieved of pleading an investment loss because the five-year statute of repose might lapse before a plaintiff realizes that it has incurred a loss due to the alleged fraud. This is fanciful given that both stock price declines and corrective disclosures are public events monitored closely by class action lawyers. Moreover, forfeiture of a potential but belated cause of action is inherent in statutes of repose, which "represent a pervasive legislative judgment [that] the right to be free of stale claims in time comes to prevail over the right to prosecute them." *United States v. Kubrick*, 444 U.S. 111, 117 (1979).

were superior to all of its competitors, but the company's stock went to zero before these misrepresentations were revealed because the automobile was invented, the alleged misrepresentations would not be the cause of that decline. If issuer corporations make misrepresentations, but a stock declines for unrelated reasons prior to any corrective disclosure, there should be no damages for the pre-correction decline. Notwithstanding that result, wrongdoers may still be subject to criminal and administrative penalties and held accountable for their actions.[20]

CONCLUSION

For the foregoing reasons, this Court should reverse the Ninth Circuit decision below with respect to respondents' claims regarding Albuterol Spiros.

Respectfully submitted,

WILLIAM F. SULLIVAN
Counsel of Record
CHRISTOPHER H. MCGRATH
TRACEY L. DELANGE
PAUL, HASTINGS, JANOFSKY
& WALKER LLP
3579 Valley Centre Drive
San Diego, CA 92130
(858) 720-2500

Attorneys for Petitioners

20. *See* Amicus Br. of Merrill Lynch at 24-30.